MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

Today, in line with our strong commitment to our price stability mandate, the Governing Council took further key steps to make sure inflation returns to our two per cent target over the medium term. We decided to raise the three key ECB interest rates by 50 basis points and approved the Transmission Protection Instrument (TPI).

The Governing Council judged that it is appropriate to take a larger first step on its policy rate normalisation path than signalled at its previous meeting. This decision is based on our updated assessment of inflation risks and the reinforced support provided by the TPI for the effective transmission of monetary policy. It will support the return of inflation to our medium-term target by strengthening the anchoring of inflation expectations and by ensuring that demand conditions adjust to deliver our inflation target in the medium term.

At our upcoming meetings, further normalisation of interest rates will be appropriate. The frontloading today of the exit from negative interest rates allows us to make a transition to a meeting-by-meeting approach to our interest rate decisions. Our future policy rate path will continue to be data-dependent and will help us deliver on our two per cent inflation target over the medium term. In the context of our policy normalisation, we will evaluate options for remunerating excess liquidity holdings.

We assessed that the establishment of the TPI is necessary to support the effective transmission of monetary policy. In particular, as we continue normalising monetary policy, the TPI will ensure that our monetary policy stance is transmitted smoothly across all euro area countries. The singleness of our monetary policy is a precondition for the ECB to be able to deliver on its price stability mandate.

The TPI will be an addition to our toolkit and can be activated to counter unwarranted, disorderly market dynamics that pose a serious threat to the transmission of monetary policy across the euro area. The scale of TPI purchases depends on the severity of the risks facing policy transmission. Purchases are not restricted ex ante. By safeguarding the transmission mechanism, the TPI will allow the Governing Council to more effectively deliver on its price stability mandate.

In any event, the flexibility in reinvestments of redemptions coming due in the pandemic emergency purchase programme (PEPP) portfolio remains the first line of defence to counter risks to the transmission mechanism related to the pandemic.

The decisions taken today are set out in a press release available on our website. The details of the TPI are described in a separate press release to be published at 15:45 CET.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

Economic activity is slowing. Russia's unjustified aggression towards Ukraine is an ongoing drag on growth. The impact of high inflation on purchasing power, continuous supply constraints and higher uncertainty are having a dampening effect on the economy. Firms continue to face higher costs and disruptions in their supply chains, although there are tentative signs that some of the supply bottlenecks are easing. Taken together, these factors are significantly clouding the outlook for the second half of 2022 and beyond.

At the same time, economic activity continues to benefit from the reopening of the economy, a strong labour market and fiscal policy support. In particular, the full reopening of the economy is supporting spending in the services sector. As people start to travel again, tourism is expected to help the economy in the third quarter of this year. Consumption is being supported by the savings that households built up during the pandemic and by a strong labour market.

Fiscal policy is helping to cushion the impact of the war in Ukraine for those bearing the brunt of higher energy prices. Temporary and targeted measures should be tailored so as to limit the risk of fuelling inflationary pressures. Fiscal policies in all countries should aim at preserving debt sustainability, as well as raising the growth potential in a sustainable manner to enhance the recovery.

Inflation

Inflation increased further to 8.6 per cent in June. Surging energy prices were again the most important component of overall inflation. Market-based indicators suggest that global energy prices will stay high in the near term. Food inflation also rose further, standing at 8.9 per cent in June, in part reflecting the importance of Ukraine and Russia as producers of agricultural goods.

Persistent supply bottlenecks for industrial goods and recovering demand, especially in the services sector, are also contributing to the current high rates of inflation. Price pressures are spreading across more and more sectors, in part owing to the indirect impact of high energy costs across the whole economy. Accordingly, most measures of underlying inflation have risen further.

We expect inflation to remain undesirably high for some time, owing to continued pressures from energy and food prices and pipeline pressures in the pricing chain. Higher inflationary pressures are also stemming from the depreciation of the euro exchange rate. But looking further ahead, in the absence of new disruptions, energy costs should stabilise and supply bottlenecks should ease, which, together with the ongoing policy normalisation, should support the return of inflation to our target.

The labour market remains strong. Unemployment fell to a historical low of 6.6 per cent in May. Job vacancies across many sectors show that there is robust demand for labour. Wage growth, also according to forward-looking indicators, has continued to increase gradually over the last few months, but still remains contained overall. Over time, the strengthening of the economy and some catch-up effects should support faster growth in wages. Most measures of longer-term inflation expectations currently stand at around two per cent, although recent above-target revisions to some indicators warrant continued monitoring.

Risk assessment

A prolongation of the war in Ukraine remains a source of significant downside risk to growth, especially if energy supplies from Russia were to be disrupted to such an extent that it led to rationing for firms and households. The war may also further dampen confidence and aggravate supply-side constraints, while energy and food costs could remain persistently higher than expected. A faster deceleration in global growth would also pose a risk to the euro area outlook.

The risks to the inflation outlook continue to be on the upside and have intensified, particularly in the short term. The risks to the medium-term inflation outlook include a durable worsening of the production capacity of our economy, persistently high energy and food prices, inflation expectations rising above our target and higher than anticipated wage rises. However, if demand were to weaken over the medium term, it would lower pressures on prices.

Financial and monetary conditions

Market interest rates have been volatile as a result of the pronounced economic and geopolitical uncertainty. Bank funding costs have risen in recent months, which has increasingly fed into higher bank lending rates, in particular for households. While the volume of bank lending to households remains strong, it is expected to decline in view of lower demand. Lending to firms has also been robust as high production costs, inventory building and lower reliance on market funding have created a continued need for credit from banks. At the same time, demand for loans to finance investment has declined. Money growth has continued to moderate owing to lower liquid savings and lower Eurosystem asset purchases.

Our most recent bank lending survey reports that credit standards tightened for all loan categories in the second quarter of the year, as banks are becoming more concerned about the risks faced by their customers in the current uncertain environment. Banks expect to continue tightening their credit standards in the third quarter.

Conclusion

Summing up, inflation continues to be undesirably high and is expected to remain above our target for some time. The latest data indicate a slowdown in growth, clouding the outlook for the second half of 2022 and beyond. At the same time, this slowdown is being cushioned by a number of supportive factors.

The Governing Council has today decided to raise the key ECB interest rates and approved the TPI. At our upcoming meetings, further normalisation of interest rates will be appropriate. Our future policy rate path will continue to be data-dependent and will help us deliver on our two per cent inflation target over the medium term.

We stand ready to adjust all of our instruments within our mandate to ensure that inflation stabilises at our two per cent target over the medium term. Our new TPI will safeguard the smooth transmission of our monetary policy stance throughout the euro area as we keep adjusting the stance to address high inflation.

We are now ready to take your questions.

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My first question is on your forward guidance and what the frontloading means for September, because you previously have been guiding us and the market that September will see a 50 basis points hike unless there are clear signs of inflation going down.

The second question is on Italy. We are seeing yields rising with the political uncertainty at centre stage. What's your message to the market? Is the TPI big enough and bold enough to prevent a potential escalation of the situation?

Actually, your question helps me give you a bit of an insight of what happened during this really important Governing Council meeting. Governing Council members around the table made two important decisions. The first one had to do with interest rate hikes by 50 basis points – and I will come back to forward guidance in a minute – and also decided to approve at unanimity, unanimity of the Governing Council, the Transmission Protection Instrument. So let me come back to the interest rate hikes that we decided, and I will come back, as a result, to your forward guidance question. We debated internally within the Governing Council about the pros and cons of sticking to the signalled 25 basis points of July, which entailed the other forward guidance that we gave in respect of September. The two of them were clearly a package. And having weighed the pros and cons we decided, on balance, that it was appropriate to take a larger step towards exiting from negative interest rates.

We did that on the basis of several indicators, several elements which we believe constituted a change relative to our June Amsterdam meeting. And I can come back to those four elements, because I think they're important. They all relate to a materialisation of inflation risks that we had flagged in Amsterdam, but which we have seen materialising in the meantime.

I think the second important component that played a role in our decision was that the situation has changed in relation to transmission. We had not implemented yet the flexible reinvestment under PEPP, and certainly we did not have at the time a transmission protection instrument. So these two elements combined - realisation of upside risk to inflation plus the presence and the operationality of the flexible reinvestment under PEPP, and, more importantly, the unanimous support of the Governing Council for the transmission protection instrument - led us to decide a larger-than-what-had-been-signalled rate hike on the occasion of this meeting. That is really what, if you want to go behind the curtain of the Governing Council debates, this is what took place.

I would add that in relation to the rate hikes we had the debate, weighted the pros and cons, and at the end of the discussion all members of the Governing Council rallied to the consensus of 50 basis points. So it's a strong indication on both accounts in relation to the higher step that we are taking to exit from negative interest rates, and on the other front, which is making sure that our monetary policy stance is transmitted smoothly throughout the entire euro area.

Now, the TPI is, obviously, an instrument that will help us deliver on our mandate of price stability, bringing inflation in the medium term back to 2%, and under that TPI all members of the euro area can be eligible; all of them. You will find in the press release later, after this press conference, the detail of